Study Group to Review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies: Second Phase
Minutes of the Fifth Meeting

Date: Monday, November 20, 2023 16:00 – 17:10

Place: Tokyo Stock Exchange 15F Special Conference Room

Attendees: See member list

Kikuchi, Director, Listing Department, TSE：

I am pleased to convene the fifth meeting of the second term for the study group to review minority shareholder protection and other framework of quasi-controlled listed companies. Thank you all for joining us today despite your busy schedules. I appreciate your cooperation.

Firstly, regarding today's attendance, Mr. Kato will join us online, about 15 minutes late. The observers from the Financial Services Agency, the Ministry of Economy, Trade and Industry, and the Ministry of Justice are also participating online.

Let's move straight into the agenda for today. I will now explain the items for discussion.

Ikeda, Senior Manager, Listing Department, TSE:

Thank you all for being here despite your busy schedules.

Please refer to Material 2. Today, we aim to compile a provisional summary of the various initiatives discussed so far in the second phase of this study group.

First, regarding information disclosure, based on the discussions in the second meeting, we plan to outline the desirable disclosure items and key points for companies in a parent-subsidiary relationship or under the equity method accounting. The details are compiled in Material 3. I will report on this and welcome any comments or observations you may have.

Next, concerning the "Roles Expected of Independent Directors," we have updated the draft as Material 4, in light of the discussions from the previous session. I will explain this and would appreciate your renewed feedback.

Lastly, at the bottom, you'll find "Consideration of Listing System Improvements to Protect Minority Shareholders." We are grateful for your multifaceted discussions on this challenging topic. Material 5 summarizes the various opinions received so far. We plan to organize and review these at the Tokyo Stock Exchange and then discuss them again in this study group. If you have any additional comments, we would be grateful to receive them.

Today's discussion will focus on those three points.

Kikuchi, Director, Listing Department, TSE：

Let’s begin with the discussion based on the materials presented. Today, we have three main topics, and we would like to explain each topic based on the materials provided by the Tokyo Stock Exchange, followed by your opinions and discussions.

First, we will explain the enhancement of information disclosure based on Material 3.

Shirozu, Manager, Listing Department, TSE:

I will now explain the contents of Material 3.

First, as stated on page 2, regarding information disclosure, we plan to compile and guide listed companies on the principles of enhanced disclosure and key points in disclosure. The details of these key points will be indicated in the preparation guidelines for Corporate Governance Reports. At the bottom of page 2, we have listed the main opinions received during the second meeting of the study group, which are planned to be reflected in the guidelines.

From the next page onwards, attached as an appendix to Material 3, are the documents that will be shared with listed companies. On page 4, under the title “Request for Enhanced Information Disclosure,” we have noted the following.

> Investors have pointed out the lack of sufficient disclosure on minority shareholder protection and group management, despite its importance for investment decisions.
>
> Based on this, TSE have organized the key points for disclosure in the governance reports as expected by investors.
>
> While these are not intended to mandate disclosure of specific items, they are important for investment decisions and serve as a starting point for dialogue with investors. Listed companies are requested to consider and respond towards enhancing disclosure.

On page 5, we summarize the background and purpose of why such enhanced disclosure is necessary. Page 6 briefly outlines the target companies and the expected actions. On page 7, we provide guidance on points to consider when responding.

From page 8 onwards, we explain for each type of company-listed parent companies, listed subsidiaries, listed companies with listed affiliates, and listed companies with other associated companies, what kind of information disclosure is expected from them and why it is required by their shareholders.

We intend to proceed with encouraging listed companies to enhance their information disclosure in this manner. That concludes the explanation of Material 3.

Kikuchi, Director, Listing Department, TSE：

As the TSE has explained about the planned measures, I would like to invite any comments or opinions you might have.

Kanda, member:

The material is very well-prepared, and I think it is quite satisfactory.

I would like to raise one point not covered in the material as a topic for future consideration. This point was discussed in another meeting, and I found it quite compelling, so I would like to mention it in this study group as well.

One of the future themes for information disclosure should be the disclosure of the extent of share ownership that directors of listed subsidiary hold in their parent or controlling shareholder companies. This could primarily apply to executive officers, but I also believe it should extend to outside officers, considering their independence, which is relevant to our next topic. This is a point that hasn’t been raised before, and it’s not something that needs to be addressed immediately in this phase, but I would appreciate it being considered for future deliberation.

Kikuchi, member:

Regarding disclosure, I have one point to add.

Relating to the second paragraph on page 7, I’d like to comment on a specific aspect that wasn’t mentioned in the TSE’s explanation. The material states, “Please refer to each company’s disclosure examples,” and since this is a document published by the Tokyo Stock Exchange, it is likely to be received by the market as a sort of good example. From this perspective, there are parts of the content that feel a sense of unease.

On page 14 and beyond, the material categorizes disclosure content as "Disclose according to the company’s situation," which is clear. However, while on the left side under "Having a situation corresponding to the above," it shows a summary of key points, on the right side under "No corresponding situation," it shows examples rather than a summary of key points. Looking at this, I feel it would be better to also provide a summary of key points for the “No corresponding situation” side. The reasons for this are, for instance, on page 14, under the second bullet point of “Example of Disclosure Content,” it emphasizes “Strengthening of business alliance or transactional relationships” in bold. However, it’s questionable whether this alone should be treated as a good example. Although it may not directly relate to the parent-subsidiary listing issues we are discussing, in terms of the disclosure of cross-shareholdings, there is an argument about whether such expressions have become templated and whether there is a need for improvement in disclosure content. In light of this, I felt that presenting such examples could be counterproductive.

To make my point clearer, let’s take another specific example. On page 15, under the second bullet point of "Example of Disclosure Content," it states, "Management is only conducted from the perspective of risk management and compliance, without involvement in the business management side." Since risk management is also an essential aspect of business

management, the statement "no involvement in the business management side" seems inconsistent and questionable as an example. Therefore, for cases where "No corresponding situation" applies, organizing what items should be explained would make the document clearer and easier to understand, considering the balance between both situations.

Ouchi, member:

Based on the survey of major companies conducted by the Policy Planning Sub-Committee of the Economic Law Committee of the Japan Business Federation, I'd like to make a few points.

Firstly, it was mentioned that the purpose of this initiative is to elevate the overall standard of disclosure. Companies that are currently providing extensive disclosures are doing well, and it's important to note that level of compliance somewhere in the document. For example, on the fourth line of the third paragraph on page 4, after the phrase of "Given that this information is the starting point for dialogue," adding a phrase like, "Especially aimed at companies that have been reluctant to disclose information," would clarify this point. This is a request from the issuer's side, but I believe such an expression would make the intent clearer.

Secondly, regarding companies in an equity method relationship, from the issuer's perspective, although profits are consolidated to a certain extent due to the equity method, in reality, most do not share strategies at all. My actual feeling is that they have no influence on decision-making. More frankly, they don't listen to us as shareholders. Usually, the response from them is "let us do what we want as a listed company please." As the range of influence, conversely speaking, the scope to which we should be concerned about excessive discounting due to opaqueness of positioning within the group from an external perspective, companies in an equity method relationship is a bit too broad. While I understand the rationale for setting the equity method relationship as a standard, this is how it feels in practice.

Therefore, considering that potential influence over the appointment and dismissal of directors is a criterion, it might be a good idea to set a threshold. For instance, if the percentage of voting rights exercised at shareholders' meetings exceeds 80%, owning more than 40% would mean the ability to dismiss directors at any time.

I am participating in this meeting entrust with opinion from discussions within the Japan Business Federation, which suggested that disclosure for companies in an equity method relationship should be stopped. While not all disclosures are unnecessary in such cases, uniformly targeting all companies, including those with a 15% stake and meeting certain criteria for equity method application, seems a bit too broad and premature.

Thirdly, regarding the asterisk on page seven, which reads, "In cases where disclosure is difficult, such as when it may cause operational difficulties or adversely affect the market," while I appreciate your consideration, I feel the expression is a bit too strong. Ideally, the scope of disclosure should be limited to the content that has an impact on investment decision by stating "Disclosure is not expected in cases where it is difficult, but in cases that are important for investment decisions." This aligns with the first paragraph on page 4, which mentions, "Despite the importance of information on minority shareholder protection and

group management for investment decisions" as a lead-in to why disclosure is necessary. Expanding the consideration described next to the asterisk would make the intent more consistent.

Goto, member:

In preparing for today's meeting, when consulting with our on-site staff, they suggested, "Tell them to stop all disclosures as it increases our workload." However, I believe we should consider what the ideal situation should be. From that perspective, effectiveness is crucial. It's important for both the disclosing and the reading parties to find the disclosure meaningful. It would be disappointing if the issuers went to great lengths to produce extensive disclosure documents, only to find them not being utilized effectively by the readers.

Therefore, the discussion on materiality, determining which companies should be subject to disclosure, becomes very important. Even setting aside the practical burden, as mentioned earlier, companies under the equity method should be required to disclose, I believe. On the other hand, for investments made purely for investment purposes or through funds, disclosure requirements from the perspective of group management clearly deviate from the purpose.

While the discussion primarily revolves around TSE-listed companies, there are also companies listed on foreign markets. In some of these foreign markets, stricter disclosure rules are already in place. For companies listed in these foreign markets, as a first step, it might be sufficient to trust the governance of those markets. If issues arise, then the rules of the TSE can be revised accordingly.

Additionally, to create efficient disclosures, distinguishing between mandatory and voluntary disclosures and formalizing these rules could also be effective.

Sampei, member:

Reflecting on the opinions shared earlier, regarding companies subject to the equity method, it was mentioned that most such companies do not share strategies with their holding or beheld companies, and that they are thought to have no influence on decision-making. I agree that this should be the norm.

However, in reality, when I've invested in companies concerned about conglomerate discounts, a simple answer to the question of why the discount occurs is often, "Equity method companies are not considered in future cash flow projections." For companies I currently advise, it's similar. When I'm saying "Equity method companies are not part of the DCF valuation's present value calculation. You only add the value of the equity stake, i.e. when explaining corporate value, future cash flow is key, but equity method companies are not included. Therefore, forming a group with equity method companies, which is a rather half-hearted approach, is disadvantageous," the companies are surprised very much. I have an impression the situation in which companies are surprised by the fact that contribution of equity method companies to the group's corporate value is not recognized by investors does not so much align with the earlier comments. Ideally, if everyone had the understanding

mentioned earlier, it would align with valuation and not be a problem. However, in reality, many corporate individuals do not share this understanding. This is more of a personal observation, but I wanted to share it.

Kikuchi, Director, Listing Department, TSE：

Thank you for your input.

Based on the opinions received today, we plan to make revisions and share the material with you before its public release.

Now, let's move on to the discussion on "Roles Expected of Independent Directors" based on Material 4. First, let us make explanation.

Shirozu, Manager, Listing Department, TSE:

I will provide a brief explanation of Material 4. As we have already provided a preliminary explanation, I will keep this concise.

The material is a draft outline regarding the "Roles Expected of Independent Directors." It has been updated to reflect the discussions from our previous session. The sections highlighted in yellow indicate the content that has been updated. I will focus on explaining the intent behind these updated areas.

Firstly, at the beginning of the document on page 2, we outline the main message. Initially, it declares that "in listed companies with controlling or quasi-controlling shareholders, independent directors bear the important role and responsibility of protecting the interests of minority shareholders." Following this, it states the following.

This document consolidates their roles, considering specific scenarios.

It targets not only companies with controlling shareholders but also broadly includes those with quasi-controlling shareholders.

TSE hopes that independent directors in such companies will refer to this document to effectively protect minority shareholder interests.

The bottom of page 2 explains the TSE's intention behind compiling this document.

Page 3 illustrates the structure of the document. The change from the previous version includes categorizing supervision and involvement into three parts: first, establishing a supervision system; second, day-to-day supervision; and third, deliberation and decision-making.

Page 4, marked as 1., outlines the basic principles of minority shareholder protection.

Page 5 explains why protecting minority shareholder interests is important in listed companies. Page 6 discusses how supervising conflict of interest risks is central to this, with content similar to the initial draft.

From page 7 onwards, marked as 2., the document elaborates on the roles expected of independent directors.

On page 8, following the feedback from the last meeting, we have reorganized the content to clarify the following.

Directors of listed companies bear the responsibility of enhancing corporate value, which includes protecting the interests of minority shareholders.

Directors other than independent directors are more susceptible to the influence of controlling shareholders, hence, the role of protecting minority shareholder interests is particularly expected of independent directors.

Page 9 discusses how independent directors supervise conflict of interest risks in the boardroom, emphasizing the following.

Besides direct deliberation and decision-making on transactions or actions with conflict of interest risks, there may be a case of day-to-day supervision.

It's crucial to establish a system that distinguishes between these modes of supervision and ensures appropriate involvement.

Page 10 focuses on the establishment of supervisory systems, outlining that independent directors are expected to actively seek necessary systems and support. Page 11, building on the previous draft and incorporating feedback, notes the importance of routine dialogue with controlling shareholders and their independent directors. Page 12 adds considerations for deliberating and making decisions on specific transactions or actions with conflict of interest risks, emphasizing the need for fairness in procedures and reviewing comprehensive decision-making processes.

Page 13, reflecting previous feedback, clarifies the scenarios in which special committees are utilized. Page 14 states that such special committees should primarily consist of independent directors, who are expected to play central roles like chairperson.

From page 15 onwards, the material analyzes different types of transactions and actions that are subject to supervision due to conflict of interest risks. This analysis includes the following: On page 16, the first type is direct transactions. On page 17, the second type involves business transfers or adjustments. On page 18, the third type concerns the transformation into wholly-owned subsidiaries. Each type is organized in terms of the location of conflict of interest and elements to consider, following the structure of the previous draft.

Page 19 outlines that in cases where the listing rules require external expression of opinion, independent directors are expected to undertake this responsibility, based on the earlier draft.

Page 20 adds a slide to expand on the role of independent directors in nominating candidates for such positions, highlighting the importance of establishing a supervisory system for conflict of interest risks beforehand. This aspect slightly differs from transactions and actions.

Starting from page 21, the material describes the necessary responses from companies and boards of directors to support the role of independent directors. At the beginning of page 22, based on previous feedback, it's emphasized that the board of directors within the company should primarily provide this support. The following sections, based on the previous draft, detail the required support in terms of governance structure, board operation, and information disclosure.

This concludes the explanation of Material 4, focusing on the updated sections.

Kikuchi, Director, Listing Department, TSE：

I would like to hear opinions from the members. Please feel free to share your thoughts.

Goto, member:

One point that we are also mindful of, particularly when looking at pages 10 and 11 of the material, is that the descriptions seem very considerate towards the issuing companies. Adding new duties to outside directors could pose a significant obstacle to their appointment and retention, which is a concern for our company.

Instead, the roles expected of outside directors, as outlined, are appropriate and necessary. These roles should be executed, however, it should be reliably executed within the normal board meetings. Therefore, It the appointment of more outside directors in listed companies than is currently the case, or what the board of directors should be, needs to be enforceable with, in some cases, enough force to mandate. Without such measures, it may be difficult for traditionally conducted board meetings to meet expected standards. In our company, more than half of the directors are external, and we believe that by thoroughly improving the quality of our board and executive meetings from a governance and compliance perspective, we have met the level indicated in the material. Of course, companies vary widely, so I think it would be beneficial for the TSE to encourage improvements in the quality of listed companies in this regard.

Regarding the wording, using the term "routine" might be interpreted by outside directors as needing to work regularly, which could be misleading. It might be prudent to be cautious with such terminology.

Sampei, member:

Regarding page 5 of Material 4, which discusses the significance of protecting minority shareholders' interests, while five points are listed, I believe it would be beneficial to add a bit more explanation before or after the third point. The agency problem between ownership and management is well-understood in general. The conflict of interest between minority and controlling shareholders can also be seen as an agency problem between the economic interests of minority shareholders and the managerial control of controlling shareholders. It appears that many companies, from the perspective of controlling shareholders, feel that the

agency problem is nearly resolved due to the alignment of ownership and management. However, in this scenario, there is a concern that decisions may be made by overpowering minority shareholders' economic interests, thus exacerbating the agency problem for them. Therefore, it's important that controlling shareholders adequately consider the economic interests of minority shareholders. The issue is that under the circumstance where agency problem has not yet been resolved between controlling and minority shareholders, while one party believes the problem is resolved, the other sees it as intensifying. This gap itself presents a serious conflict of interest. Adding an explanation to highlight this as a starting point of the issue could be helpful.

If controlling shareholders could share interests common to all shareholders, including minority shareholders, it would be a beneficial structure for both and indicate well-managed group operations. This is a point often emphasized by parent companies, but it's important to understand that this is true only under such conditions, and efforts should be made to establish those conditions.

Regarding the highlighted text with the yellow marker, starting with the arrowheads around the middle of page 6, it would be more understandable if there was a basis for this. One can find such a basis in the updated G20/OECD Principles of Corporate Governance 2023, released in September this year. Specifically, this is clearly stated in Section V, "The responsibilities of the board," paragraphs B and E, and also in Section II, "The rights and equitable treatment of shareholders and key ownership functions." Since these values are globally shared, noting this somewhere in the document could clarify the foundation of these ideas.

Regarding the third paragraph on page 6, globally relevant specific measures can be found in the ICGN Global Governance Principles. Specifically, Guidance 10.10 states that "if a board-endorsed resolution has been opposed by a significant proportion of votes (e.g., 20% or more), the company should explain subsequently what actions were taken to understand and respond to the concerns that led shareholders to vote against the board's recommendation." Furthermore, "at the following AGM, the board should report how the views from shareholders were considered to address the concern and any actions taken." This emphasizes the need to properly consider minority shareholders' interests. Although minority shareholders' opinions may not directly influence the resolution outcome at the meeting, it encourages addressing the concerns they express through their opposing votes. Mentioning this as a reference point would be beneficial.

On pages 13 and 14, special committees are discussed. While I believe the content as written is satisfactory, some additional explanation could be helpful. The guidelines for fair M&As published in 2019 detail the timing and composition of special committees, and in August this year, the Ministry of Economy, Trade, and Industry issued guidelines for corporate takeover. While these may seem similar, and the scope has expanded from the fair M&A guidelines to the guidelines for corporate takeover, the descriptions of the establishment of special committees differ between the two. Since the starting point of Material 4 aligns with the perspective of the fair M&A guidelines, making it clearer that the explanations from these guidelines are more relevant for understanding the significance of establishing such committees would be beneficial.

Regarding the composition of special committees on page 14, both sets of guidelines from the Ministry of Economy, Trade, and Industry are consistent, so there should be no confusion there.

However, as the latest guidelines are fresher in memory and people might wonder if they differ in their depiction, a bit of additional clarification would be helpful.

Regarding the last point on page 23, specifically the yellow-highlighted section at the bottom, I believe this reflects what I had mentioned in the study group. While the essence of the content is fine, I'm concerned that the phrase in parentheses, "especially in cases where special committees are established on a non-permanent basis," might be misconstrued as suggesting that having non-permanent special committees is undesirable. It should be made clear that having non-permanent special committees is acceptable. The issue lies in ensuring that, when such committees are established, their composition is foreseeable. Without this, institutional investors might find it difficult to understand what kind of special committee will be formed, which could lead them to conclude that the system is inadequately prepared for managing structural conflicts of interest, thus reflecting in their voting decisions. It's important that the composition of these committees, when they are to be established, is clear, not necessarily the names of the individuals, but the number of independent directors and the types of other members involved. Such disclosure would allow investors to judge whether the system is sufficiently robust. Therefore, I suggest making it more explicit that having non-permanent committees is not an issue, but the key is to clearly disclose their prospective composition.

Ouchi, member:

I also believe that the third paragraph on page 5 is central to the concept of this discussion. The inclusion of the phrase "common interests of shareholders" is very apt. However, following the text as it is, it states that "the interests of minority shareholders can usually be expressed in other words as the common interests of shareholders, and conversely, if the interests of minority shareholders are harmed, it implies that the interests of the listed company are harmed." This leaves it unclear whether it includes or excludes exceptional situations or events. I think the underlying premise should be that "unless there are special circumstances, minority shareholders typically only have an economic interest." Therefore, when applying these rules, it's important to constantly consider and be mindful of whether we are now in an extraordinary situation or not. The content might imply this, but to be more explicit, instead of saying " expressed in other words," it might be better to say "regarded as equivalent to" the common interests of shareholders. In other words, looking at the interests of minority shareholders can generally guide us towards achieving the common interests of all shareholders. That's my first point.

Furthermore, after mentioning "aligns with the interests of the listed company," it might be helpful to add a clause like, "thus, this discussion is based on the assumption that no special circumstances are present." This way, while reading each section, it's indicated that different rules might apply in special circumstances, deepening the discussion.

Regarding the phrase "conversely," as it stands, it doesn't reflect the current awareness of the issue, and it could be read as a complete equation: "If the interests of minority shareholders are harmed, it means the interests of the listed company are harmed." To prevent any misunderstanding by readers later, adding a phrase like "in the absence of special circumstances" before "If the interests of minority shareholders are harmed," would clarify that we always need to be vigilant about whether an extraordinary situation exists

where the interests of minority shareholders cannot be equated with the common interests of shareholders. I suggest making this perspective explicit.

Kansaku, member:

Regarding page 3 of Material 4, I appreciate that it effectively reflects discussions from the Financial Services Agency’s follow-up meetings, the Ministry of Economy, Trade, and Industry’s guidelines on outside directors and group governance, and various soft laws, as well as the discussions of this study group. I fundamentally agree with it, especially appreciating the point in 2-6 about "the nomination of independent director candidates" playing a certain role.

One clarification I’d like: concerning the scope, page 2 states that independent directors play an important role and bear significant responsibility in listed companies with not only controlling shareholders but also “quasi-controlling shareholders.” This is excellent. However, regarding the meaning of “quasi-controlling shareholders,” the second paragraph on page 2 seems to define it as holding a significant but not majority voting right, thus having substantial control. I understand there’s a discussion on defining or expanding the definition of “controlling shareholders,” but for now, does this mean each listed company should consider the scope of “quasi-controlling shareholders” themselves, as an ongoing study issue, as mentioned in Material 5? I’m seeking clarity on whether there will be future discussions to clarify the meaning of “quasi-controlling shareholders,” as the positioning seemed a bit unclear.

Shirozu, Manager, Listing Department, TSE: Thank you for your question.

Firstly, Material 4 is intended as a guideline for codes of conduct rather than a rule, with the expectation that it will be referred to by independent directors of various companies. We are asking these directors to play such roles, particularly in companies where they consider the influence of shareholders to be strong, based on their own situations. Therefore, the definition of "quasi-controlling shareholders" is not delineated as a rule with a clear application scope but is rather described abstractly as shareholders with "substantial control."

On the other hand, as you pointed out, expanding the rules to include "quasi-controlling shareholders" is recognized as an issue for further study and is mentioned in Material 5. When considering it for rule-making, it’s necessary for the Exchange to clearly define the target scope. How to draw the line and what criteria to consider for materializing the concept of substantial control will be significant issues for discussion. If "quasi-controlling shareholders" are to be included in the rules, a clear definition will be needed.

Kansaku, member:

Thank you for your response.

If a future rule-based definition for "quasi-controlling shareholders" is established, it might not necessarily align with the range described as "quasi-controlling shareholders" in Material 4. Since the same term is used, I was concerned about potential misunderstandings. Could you please confirm this?

Shirozu, Manager, Listing Department, TSE: Thank you for your question.

Indeed, there might be a slight difference in scope between Material 4, which targets shareholders with substantial control as perceived by the company, and a future rule-based definition, which would likely be more formally structured. While we haven't yet decided on how to define "quasi-controlling shareholders" in the listing rules, if we do establish a definition, we will ensure clarity and avoid confusion by updating Material 4 accordingly.

Ikeda, Senior Manager, Listing Department, TSE:

In light of this, we will consider revising the wording in Material 4 to prevent confusion due to the use of the term "quasi-controlling shareholders."

Kanda, member:

I find Material 4 generally satisfactory. However, fully articulating its content in Japanese without any omissions or excesses is challenging. From this perspective, I have two comments.

Firstly, I believe it's important to convey that the role of independent directors in general listed companies differs from that in quasi-controlled listed companies. Although the text in the document is intended for this purpose and communicates this message throughout, that's my first point.

Secondly, I'd like you to advocate that, as the code of conduct for such independent directors, abstractly speaking, their behaviors in the board of directors and those in special committees should distinguished. I believe this point might be debatable, but the document aligns with my view.

In the board of directors, as mentioned in the material, there are two key duties: maximizing corporate value and the common interests of shareholders and ensuring the distribution of profits aligns with the ownership ratio, such as ensuring the 6:4 distribution between controlling and minority shareholders when the ownership ratio is 6:4. Thus, if there are projects that can increase corporate value by JPY100 and JPY200, respectively, the latter should be chosen. However, the resulting profit distribution should maintain the 6:4 ratio. This is the role of the board. In contrast, the role of special committees, especially in cash-out scenarios, is primarily to secure the interests of minority shareholders.

In these latter cases of cash-out, it's appropriate to negotiate for the highest possible price. However, since it will be negotiated with the party conducting cash-out, the final agreement usually settles within a fair price range, and I think the only conclusion that can be reached

over what that fair price is that there is no problem if proper procedures are followed as indicated in the guidelines by the Ministry of Economy, Trade, and Industry, which ensure fairness. Nevertheless, the objective of a special committee is to maximize the interests of minority shareholders, so independent directors serving on such special committees are expected to adhere to this code of conduct. Therefore, it’s crucial to communicate that the code of conduct for directors and for special committees differs, to avoid confusion among those interpreting these roles.

Kikuchi, member:

There is some overlap with Mr. Kanda’s remarks, but I have one point to make.

Material 4 is titled “Roles Expected of Independent Directors in Listed Companies with Controlling or Quasi-Controlling Shareholders.” Based on the premise that it specifically addresses the roles expected of independent directors in such companies, not general independent directors, we should clearly specify some unique aspects.

Regarding the term "routine" mentioned by Mr. Goto, I agree that it might lead to misunderstandings. However, as can be understood by reading page 10 and page 11 consecutively, the document states that appropriate supervision is necessary according to the significance of day-to-day transactions and activities. It implies that the role of independent directors isn’t limited to emergency situations. While the wording could be reconsidered, it’s essential to clearly communicate that, on the premise that they don’t have to supervise every day-to-day minor transaction, "routine" actions are expected from independent directors in companies with controlling shareholders. Therefore, as other members have pointed out, the document appropriately clarifies the role of independent directors in special companies with controlling shareholders, especially in aspects like their appointment and the formation of special committees.

Kuronuma, member:

Generally, I think the description of the roles of independent directors in listed companies with controlling or quasi-controlling shareholders, as stated in Material 4, is adequate.

However, I find the section on page 13 about the purpose of establishing special committees somewhat unclear. The first bullet point in the third paragraph describes a scenario where, "if the proportion of independent directors in the board is low, they can function as a group within a special committee to supplement the supervision by the board." This seems to imply, as Mr. Kanda mentioned earlier, that independent directors need to pursue the interests of minority shareholders. The suggestion might be that they can become a majority within the special committee, even if they are a minority in the board, to achieve this. If that’s the intended message, I believe the wording could be refined for clarity. This comment is also meant as a question for further clarification.

Shirozu, Manager, Listing Department, TSE:

Thank you for your question. While I will reconsider this in light of Mr. Kanda's comments, let me explain the initial thought.

First, the point made in the first bullet under the third paragraph is based on the principles of the Corporate Governance Code. The basis is the appropriate consideration of conflicts of interest within the board of directors. The first approach encourages having a ratio of independent directors on the board at either one-third or more than half. The second approach, for cases where this is not achievable, involves establishing a special committee centered around independent directors to complement the supervision by the board. In such a special committee, the primary focus is on supervising conflicts of interest, aiming not so much at maximizing minority shareholders' interests, but rather at ensuring a fair distribution, as Mr. Kanda mentioned, like maintaining a 6:4 ratio.

Regarding the second bullet point, which discusses "cases requiring particularly careful consideration of conflict of interest risks," the role is thought to be maximizing minority shareholder interests, as outlined in the Fair M&A Guidelines.

Currently, it seems the way the role is executed might vary depending on the purpose of the committee's establishment. However, I would like to reorganize this and reflect it appropriately in the document.

Kuronuma, member:

I understand the original intent of the text and acknowledge that further consideration will be given to it.

Kato, member:

Regarding the content on page 5 and page 6, as mentioned by Mr. Sampei and Mr. Ouchi, I'd like to add a point.

As Mr. Sampei correctly pointed out, in listed companies with controlling shareholders, there is an undeniable existence of structural conflicts of interest between the controlling shareholders, minority shareholders and the company itself. However, the essence of the current document is that by appropriately addressing these structural conflicts of interest, it's possible to align the interests of controlling and minority shareholders, thereby reducing the instances where the interests of controlling shareholders diverge from those of general shareholders. In short, the aim is to make cases where the interests of general shareholders are harmed due to conflicts of interest the exception. Therefore, situations like those mentioned by Mr. Ouchi are precisely what this document aims to address. Adding a statement on page 5 or page 6 about ensuring that the interests of controlling and general shareholders align through the proper handling of structural conflicts of interest risks will enhance the understanding of the significance of this discussion.

Takei, member:

Firstly, regarding Material 3, I did not comment earlier, but I think it's an important document and well-prepared.

Now, on Material 4. As usual, let's refer to the parent company as P and the subsidiary as S.

I think Material 4 has the potential to be read in many different ways by many different people. One perspective of why I think so is that S's independent directors primarily have a legal duty to enhance the value of S. It should be ensured that this document does not create a misunderstanding that S's minority shareholders are always right and P is the bad guy depending on the situation, so to speak. I understand that this is not the intention of Material 4, but there might be a misinterpretation that S's minority shareholders must always be maximally protected. For instance, in the 6:4 example mentioned earlier, it should be clear that going beyond securing 4 for minority shareholders to a 3:7 or 0:10 distribution is not the intended message. We should be careful to prevent such extreme interpretations.

From this viewpoint, various expressions are used throughout the pages. Initially, on page 5, the term "appropriate protection of minority shareholder interests" is used, which I think is appropriate. This term is also used in the Corporate Governance Code, as seen on page 8. However, as the document progresses, phrases like "protection of minority shareholder interests" or "maximization" appear, which could be interpreted differently by some readers.

Especially regarding special committees, in squeeze-out scenarios, the Fair M&A Guidelines provide clear guidance, so there's less risk of misinterpretation. However, as mentioned on page 16, a committee might be established, aside from permanent or non-permanent, to ensure that transactions between P and S do not harm S's minority shareholders. In such cases, it shouldn't mean going beyond a 6:4 allocation to demand more aggressive terms from P or to assert that S should not engage with P unless more benefits are obtained. Current practices rightly focus on arm's length transaction terms. The Fair M&A Guidelines are about ensuring appropriate benefits for S through fairness in the process, not demanding a 0-to-10 profit distribution. However, using of only terms such as "maximization" or "pursuing minority shareholder interests" in this document could potentially create misunderstandings generally. To avoid such confusion, it might be better to consistently use "appropriate protection of minority shareholder interests" throughout the document.

Under the current framework, as stated on page 19, the current system for transactions between P and S is based on the criterion that they should not be disadvantageous to minority shareholders. This standard was the starting point and initially focused on ensuring that minority shareholders' interests were not unduly harmed. I think there is no need to change this aspect on page 19.

Even independent directors of S, who have a legal duty to enhance the value of S, if the word "maximization" pertaining to the interests of specific minority shareholders is used alone, independent directors of S might find themselves in a difficult position. Therefore, it's crucial to add explanations or clarifications that emphasize the importance of securing interests through processes. The incorporation of the concept of "common interests of shareholders" is good but explaining the entire document within the framework of "appropriate protection of minority shareholder interests" could avoid complicated discussions. That's my first point.

My second point is more fundamental: I wondered whether there should be mention of independent company auditors. The issue of whether S is being unfairly disadvantaged by P is subject to audit under the Companies Act, which is the responsibility of the company

auditors, members of Audit and Supervisory Committee or members of Audit Committee. In companies with an Audit and Supervisory Committee or companies with Three Committees, it is consistent that independent directors serving as members of Audit and Supervisory Committee or Audit Committee would take this role. However, for the 60% to 70% of listed companies, which still have a Board of Company Auditors, not mentioning independent company auditors seems questionable.

For example, it would be better to note that "while this document refers to independent directors, independent company auditors should also be involved in the responsibilities of independent directors, as outlined in this paper, in light of their duties under the Companies Act." I think it would be appropriate to include some reference to independent company auditors in the document. These are my two points.

Kuronuma, member:

Reflecting on Mr. Takei's comments, I feel it's necessary to express my view.

In this study group, I believe, we have been discussing under the stance that the interests of a listed subsidiary must be sufficiently protected. This approach is not based on the notion that "since the shares of a listed subsidiary are discounted and minority shareholders buy them cheaply, it's acceptable for the subsidiary to be completely controlled by the parent company and the interest of minority shareholders are not protected."

If that is the case, I think terms like "maximization of minority shareholders' interests" and "protection of minority shareholders' interests" are necessary. Conversely, using phrases like "appropriate protection of minority shareholders' interests" or "preventing harm to minority shareholders' interests" might inadvertently imply that minority shareholders, as investors in a listed subsidiary, should tolerate certain unavoidable disadvantages. Therefore, how we express these concepts should be carefully considered.

Kikuchi, Director, Listing Department, TSE：

Thank you for your input.

Now, let's move to our third agenda item, the development of listing systems for the protection of minority shareholders, based on Material 5.

Shirozu, Manager, Listing Department, TSE:

Let me explain Material 5.

Please refer to page 2. In our study groups so far, we have considered various measures for the protection of minority shareholders in listing systems, their necessity, and challenges. In the study group this time, we've focused on enhancing information disclosure and organizing the role of independent directors in governance. However, to ensure the protection of minority shareholders, it's not sufficient to rely on these two approaches alone. We need to consider

a combination of measures and examine system-level responses. For this purpose, the TSE will undertake a detailed examination of each issue and, once a direction is clear, we will proceed with discussions in the study group. So this time, we aim to organize the status of our discussions so far.

In the lower half of page 2, we have compiled a diagram of listing system measures proposed so far. There are three major areas: first, ensuring the independence of independent directors as a prerequisite for effective supervision; second, not only expecting appropriate internal supervision for transactions and actions with conflict of interest risks but also demanding certain formal procedures to ensure fairness; and third, imposing discipline not just on quasi-controlled companies but also on controlling shareholders. We have organized possible measures for each item, from the perspective of reviewing the current rules which targets controlling shareholders and the perspective of expanding the scope to include "quasi-controlling shareholders."

From page 3 onwards, we have classified and organized opinions received so far on these topics.

Based on those current discussion, before further advancing our debate, we want to explore what kind of listing system development is necessary and what details would be appropriate.

This concludes the explanation of Material 5.

Kikuchi, Director, Listing Department, TSE：

Material 5 summarizes the current viewpoints you have shared so far, and we at the TSE intend to continue our deliberation of those matters. If you have any further comments, please feel free to share.

Kanda, member:

As we continue our deliberations, I would like to raise a particularly challenging issue for consideration. It relates to the point mentioned in the document about the "responsibilities of listed parent company." I hope that this will be a subject for your consideration.

The TSE has launched another initiative focused on "Management that is Conscious of Cost of Capital," and has issued related requests in writing. These requests are inevitably directed at listed companies, which are expected to implement these initiatives in dialogue with institutional investors. As a result, although the primary recipients of these requests are the listed companies, there is a desire to also directly address institutional investors, which is not feasible. Therefore, the documents typically conclude with a request for cooperation from institutional investors. I believe a similar issue arises in the discussion about the responsibilities of controlling shareholders.

It would be clear if there were explicit legal provisions obligating controlling shareholders to direct fiduciary duties or other obligations towards minority shareholders, but such explicit provisions do not exist. In the realm of the Companies Act, there are instances where court

rulings have indicated legal obligations for controlling shareholders in specific situations. This is a broad overview of the current situation. In this context, I think it's not complete until the TSE consider making a request or rule that not only names quasi-controlled listed company as the addressee, but also names the controlling shareholder as the addressee. On that occasion, if the controlling shareholder happens to be a listed company, it can be included in the rules as a listed entity, and this should be part of our considerations in this time. However, I believe this alone may not be sufficient. As I don't have a perfect solution myself, I suggest that if there's a similar way to send a message to controlling shareholders, as we do with institutional investors in other projects, it should be explored. While the document talks about rule consideration, I believe sending such a message to controlling shareholders as part of the overall picture is also important. I'd like to think further about what might be possible in this area, and I hope it will be taken into consideration.

Kikuchi, member:

In Material 4, there was a discussion about the role of independent directors. Among the issues identified in Material 5 that need further exploration, I believe the concept of independence poses a significant challenge. As I have mentioned on several occasions, there seems to be a discrepancy between the definition of independence and the actual practices of companies. This inconsistency is also evident in the voting guidelines of institutional investors. While it's a complex issue and should not be hastily addressed, I think it's also important to respond with a sense of urgency.

Sampei, member:

Thank you for summarizing various documents.

In light of the discussions in this study group, we will be publishing a set of guidelines. However, if only the guidelines are published, the focus might solely be on their wording. Some might wonder why such guidelines are necessary. Before the start of the second phase of the study group, the TSE conducted various fact-finding efforts. We discovered surprising realities, such as companies with a low percentage of voting rights yet holding the right to appoint directors of their quasi-controlled companies. Sharing these facts, perhaps as an appendix, and showing there are realities significantly divergent from the usual expectations of the stock market, would help clarify why the organized approach laid out in the current documents is necessary.

Related to this, I couldn't easily find information on companies under the equity method of accounting in Material 3, page 6, so I inquired with the secretariat about the number of such companies. It turned out there are about 600 listed companies that have other associated companies under the equity method of accounting. Sharing such number would help convey the scale of the issue, making the reasons for our concern more apparent.

Takei, member:

Regarding Material 4 and 5, the discussion on independence has been raised. It's not just about independence from company S's management but also considering how far to demand independence from Company P. By including this in the "Independence Tests," which is negative requirement, leading to the uniform exclusion of those who fails the Test from being independent directors. On the other hand, there's a trend towards appointing independent directors in certain proportions, like one-third or more, or even a majority. We need to consider whether it's appropriate to uniformly disqualify all candidates based on such criteria.

Concerning the conflict of interest between P and S companies mentioned in Material 4, situations like squeeze-outs are emergencies and not a regular occurrence. The extent of P-S transactions depends on S, and not all companies have many such dealings. Business transfers also aren't typically frequent. With this in mind, the extent to which outside directors of S, who should ordinarily work to enhance the company value of S, need to worry about conflicts of interest in P-S relations varies, and some companies may not face this issue often. Additionally, there's a point of discussion about how S's nomination committee for directors should be considered.

In this context, if having any relationship with P almost certainly disqualifies a candidate from being considered independent, we need to consider whether it's truly possible to find suitable candidates. Can't we operate in such a way that independence is tested on a case-by-case basis? i.e., if someone has a conflict of interest due to their relationship with P, they should be excluded at that issue because they have the relationship with P.

Since a uniform independence test means a negative requirement of exclusion in the form of not being involved approximately 100% of the time, it might be too broad and restrictive as a default standard set by the TSE. We should deliberate on this issue, keeping in mind the broader picture of how to secure independent directors in the future. That concludes my point.

Kikuchi, Director, Listing Department, TSE：

With that, I declare today's meeting concluded and will now explain the upcoming schedule.

Ikeda, Senior Manager, Listing Department, TSE:

Thank you very much for today.

Going forward, regarding both "information disclosure" and "roles expected of independent directors," we will revise the documents in the secretariat based on the feedback received today and send them to you via email. After you review them and provide any additional comments on the wording individually, we will prepare the final version, return it to you, and then communicate it to the listed companies. We plan to keep you updated on the progress and specific timing of the publication through successive emails.

Regarding Material 5, although there were opinions on the need to consider some aspects more urgently, we will first organize these internally. We will then set them as topics for discussion in the next study group meeting.

Kikuchi, Director, Listing Department, TSE：

With this, I officially adjourn today’s meeting. Thank you all very much for your participation.